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RUEHCV/AMEMBASSY CARACAS 9115
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RUEHMD/AMEMBASSY MADRID 2692
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E.O. 12958: N/A
TAGS: [ENRG](#) [ECON](#) [ETRD](#) [EAID](#) [SENV](#) [PE](#)
SUBJECT: CAMISEA II PROMISES JOB GROWTH AND EXPORT REVENUES

REF: A) LIMA 0316

B) 05 LIMA 3375

¶1. (U) SUMMARY: Peru LNG, a consortium led by Hunt Oil, recently held a groundbreaking ceremony for construction of its \$1.3 billion Liquefied Natural Gas (LNG) plant, Camisea Phase II. Construction should add 5,000 direct jobs and up to 30,000 more indirect jobs to Peru's economy. Peru LNG is investing \$2.5 billion in both Camisea I and II; LNG exports to Mexico and the United States should begin in 2009. Plans call for 4.2 million metric tons of LNG to be exported per year from 2009, adding \$200 million annually in royalty and tax revenues to the central and local municipal governments. There are no significant environmental problems under Phase II, Peru LNG is working to avoid the breaks experienced by the Camisea I pipeline. The groundbreaking reignited public debates whether Peru's natural gas reserves are sufficient to cover both internal needs and export commitments. END SUMMARY.

CAMISEA II LAUNCHED

¶2. (U) Peru LNG held a groundbreaking ceremony for its Liquefied Natural Gas (LNG) Plant at Pampa Melchorita on January 12, 169 km South of Lima. Peru LNG (major investors include U.S. Hunt Oil, Korea's SK Corporation and Spanish Repsol) and the GOP signed an agreement guaranteeing tax and foreign exchange stability for the construction of the liquefaction plant planned for exports to Mexico and the U.S. The project, commonly called Camisea II, will liquefy natural gas piped from the Camisea and nearby (projected) fields. The project includes a nearly 400-kilometer 34-inch diameter gas pipeline from the eastern side of the Andes Mountains to the Peru LNG facility. A sea wall around 800 meters long, to be located 1400 meters offshore will protect the marine terminal and ships during loading.

ECONOMIC IMPACT OF CAMISEA

¶3. (U) During the ceremony, President Toledo emphasized the legacy that Camisea and other projects would leave for the

Peruvian people in export revenues and jobs. According to Peru LNG, the export project will add approximately one percent to Peru's GDP during the construction period. Estimated royalties and taxes to the central government and to the local governments along the new pipeline and surrounding the plant will total approximately \$200 million per year. Construction of breakwater, plant, access roads and pipeline will create about 5,000 direct jobs. Indirect jobs created are estimated to be around 30,000. Operation of the pipeline spur, liquefaction plant and export terminal should maintain around 3,000 Peruvian jobs over the 18.5-year life of the project. President Toledo stated that the combined impact of Camisea I (natural gas for internal consumption) and Camisea II would add 2 percent of growth to Peru's GDP.

NO SHORTAGE OF CRITICS

¶4. (SBU) Several critics, two of them former ministers of Mines and Energy (of the APRA and Paniagua Administrations) have accused the GOP of promoting exports at the expense of the domestic market. The news that future LNG exports will occur in three years has made several critics question the sufficiency of Peru's natural gas reserves.

¶5. (SBU) Several candidates for the upcoming April presidential elections, including conservative Paniagua, APRA's Garcia and anti-establishment Humala have voiced their criticism against the Camisea contracts. Paniagua alleges discretionary assignment of the LNG plant contract to the Peru LNG consortium; that the price of liquefied petroleum gas (LPG) (which Camisea does not produce) is too high in Peru and the amendment of the Block 88 concession (to allow export of gas in excess of domestic consumption) favored Peru LNG. Garcia has called for a renegotiation of the Camisea contract as being "indispensable" and Humala promised to "review" all (major) contracts with large foreign companies.

¶6. (SBU) As the government tries to induce consumers, transporters and industries to convert to natural gas, critics highlight that Peru's natural gas and LPG prices are higher than those of Argentina. (Note: the GOP does not subsidize nor controls the price of natural gas and other fuels as do some of its neighbors, but Camisea operator PlusPetrol is allowed to charge prices for natural gas based on a formula of petroleum product market prices. Yet, prices of natural gas in Peru are well below world market prices. End Note.) As a result, the Energy Minister Glodomiro Sanchez stated to the press in mid-February that natural gas prices may decrease, that continuing rumors of an energy ring deal with Chile are unfounded and that Peru's natural gas reserves still stand at an estimated 11 trillion cubic feet -- enough to meet Peru's projected consumption for the next twenty years.

STILL NEEDED: MORE PROVEN GAS BEFORE EXPORTS ARE POSSIBLE

¶7. (SBU) Domestic Camisea natural gas consumption in 2005 (77.9 million cubic feet per day) was merely 60 percent of the MEM's 2003 forecast (130 million cuftpd) and just 87 percent of its early-2005 estimate (89.5 million cuftpd). Consumption thus has not yet reached the capacity of the Camisea field. However, under a 1999 Peruvian law, a natural gas concessionaire must guarantee the long-term supply for domestic demand before it can export. In Camisea neighboring blocks, the Camisea consortium (Pluspetrol, Hunt, SK, Tecpetrol and Sonatrach) also has an exploration-production concession for Block 56 (Pagoreni), while Petrobras has one for Block 58, and Repsol and Burlington for Blocks 57 and 90. In May 2006, Peru LNG plans to start drilling up to six wells in Block 56 during a two-year period. The companies with concessions around Camisea are optimistic about finding more natural gas reserves and are more confident now that construction of the LNG plant has

begun, with preparatory exploration work in train.

CAMISEA II AND THE ENVIRONMENT

¶18. (SBU) The natural gas and liquids pipelines from the Camisea I field (Block 88) in Cuzco's jungle experienced four cracks during the first 15 months of operation, likely due to seismic and weather-related conditions (i.e., earth slides after rains). Because of a safety system of valves, and the relatively minor effects of natural gas liquids spilling over the ground/rivers, the breaks in the pipelines have not caused significant environmental damage, but they have interrupted revenues. Peru LNG has learned these experiences and is taking measures to reinforce the new pipelines.

¶19. (SBU) Ministry of Energy and Mines (MEM) Hydrocarbons Director Gustavo Navarro told Econoff that Camisea II did not have environmental impact assessments problems. During meetings with several NGOs that have criticized the environmental protection of Camisea I, they noted that they had no significant issues with the plant, seawall or export terminal. They all reported that Peru LNG's site (chosen after extensive environmental vetting) was not in an ecologically fragile zone and they expected few environmental problems from the plant's operation.

¶10. (SBU) Local fishermen complain that the sea wall and shipping terminal will interfere with their livelihood. (Note: In view of the rich fishery that exists all along the Peruvian coast, and the relatively small impact that the sea wall is expected to have, the fishermen's complaints appear to be based more on a desire to obtain money than a legitimate concern. The MEM's energy environment bureau has urged the fishermen to support their claim with hard data. End Note.)

SQUATTERS FLOCKING ALREADY

¶11. (SBU) Although the site of the Peru LNG plant is a desert wasteland with no water or vegetation, hectares of shacks have already sprung up around the area. Peru LNG officials told Econoff that while some shacks are inhabited as people move to the area in hopes of finding work, many are erected as a sort of squatter's speculation; many squatters hope that by possession, they may be able to establish title to the land by the time there is enough development to make the land valuable.

COMMENT

¶12. (SBU) The signing of the Peru LNG/GOP agreement will contribute to U.S. energy security and be a boon for Peru's future development, particularly as the country becomes a net exporter of energy. This positive trend will be amplified if companies with oil and gas concessions around Camisea strike gas, as they expect, which could triple the initial capacity of Peru LNG's plant. A February 24 visit by Econoff to the site showed construction was well underway.

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